ASF's position on Green Paper on Shadow banking

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Response to the European Commission's public consultation on 19th March 2012

PREAMBLE

The ASF welcomes the European Commission's initiative to debate on activities classified as "shadow banking" and thanks for the opportunity that it is given to express its opinion.

The ASF supports the overall idea of updating the European legal framework for prudential supervision in order to achieve the dual objective of improving the resilience of the global financial system and ensuring a level playing field based on a robust set of prudential requirements.

Nevertheless, we do consider that the term "*shadow banking*" is not appropriate. This terminology gives a negative coloration to activities and entities concerned and deserves, in our view, to be modified.

Please find hereafter the ASF's comments on the five questions that appeared to us to be fundamental.

WHAT IS SHADOW BANKING?

Question a: Do you agree with the proposed definition of shadow banking?

As Commissioner Michel Barnier explained last 27th April 2012 at the Conference held in Brussels on shadow banking, the Green Paper firstly aims at clarifying, and even defining, what shadow banking is, before trying to determine what regulation and supervision should apply.

According to the ASF, are part of the shadow banking system: "***financial entities that are active in intermediation or credit providing but do not accept deposits from the public and are not submitted to authorisation and supervision requirements by competent authorities, neither to prudential requirements comparable to those applied to banks in terms of robustness, though adapted to the risks they represent".***

In addition to the distinction based on the status of authorised entity and the non-deposit-taking specificity, we consider that the following criteria should be used to determine what is in the scope of the shadow banking system and what is not:

- the nature of the activities/business (consumer credit lending or financial leasing cannot reasonably be treated the same way as money market funds);
- the existence, nature and level of risks (systemic risk in particular) ;
- the possibility of "run" effects (sudden and massive withdrawals of funds by clients).

Question b: Do you agree with the preliminary list of shadow banking entities and activities? Should more entities and/or activities be analysed? If so, which ones?

According to the draft Regulation on prudential requirements for credit institutions and investment firms (CRR), a "*credit institution*" is an undertaking the business of which is to receive deposits or other repayable funds from the public and to grant credits for its own account. This means that a financial institution which does not receive deposits or other repayable funds from the public is excluded from the scope of the CRR[1].

But the exclusion of financial institutions from the scope of European supervisory and prudential requirements does not mean that these institutions are not subject to regulation or supervision at national level, in which case they are not part of the shadow banking system. For instance, activities such as leasing or factoring are regulated and supervised in certain European countries and not in others.

This very peculiar situation is due to the fact that the second coordinating Directive of 15 December 1989 (n°89/646/CEE) has harmonised the definition of "*credit institution*" –definition that was taken up by the draft CRR– but not the definition of a "*banking or credit transaction*". As a consequence, similar financial activities are subject to different legal requirements leading to a significant variation in definitions from one country to another within the European market.

Thus, entities which, without collecting deposits, provide consumer lending (40% of the market in the United Kingdom is not regulated), propose financial leasing (UK, Germany…) or factoring (Germany, UK, Spain, Netherlands, Belgium, Czech Republic, Denmark, Luxembourg and Poland) would be concerned.

Accordingly, the preliminary list of activities shall include:

- lending activity, as defined in Annex I of the directive 2006/48/CE[2] and in the draft CRR (which includes: consumer credit, credit agreements relating to immovable property, factoring with or without recourse) ;
- guarantees and ;
- financial leasing.

Question c: Do you agree that shadow banking can contribute positively to the financial system? Are there other beneficial aspects from these activities that should be retained and promoted in the future?

Specialised financing as financial leasing, factoring, consumer credit or real estate leasing are actively involved in financing the real economy in France and in Europe.

Those activities are also designed to avoid a possible risk of credit crunch due to Basel III requirements, the implementation of which will be capital and liquidity consuming.

Moreover, those activities cannot, because of their nature, lead to sudden and massive "runs" and are no more volatile or cyclical than the real economy itself is.

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[1] *However, when belonging to a banking group, financial institutions are indirectly subject to CRR rules through their application at consolidated level.*

[2] *List of activities subject to mutual recognition (Annex I)*

WHICH REGULATION TO APPLY?

Question f: Do you agree with the need for stricter monitoring and regulation of shadow banking entities and activities?

Regulation should be harmonised and respect the principle « *same business, same rules* » expressed by the G20 since Seoul summit in 2010. It is crucial to fight supervisory arbitrage within the European Union and to ensure a level playing field between all the market actors for a similar activity. In other words, it is essential to eliminate distortions of competition among Member States while ensuring financing for the real economy (households, SME's…).

For the specialised institutions that are not « *credit institutions* », it is important to settle a relevant and intermediary regulation. Commissioner Michel Barnier acknowledged this need, mentioning for instance that "*the minimum capital to be tied up for a single operation must be comparable across all sectors to avoid encouraging any form of supervisory arbitrage*".

According to the ASF, the proposition of the European Commission to adopt new regulation specifically directed at shadow banking entities or activities rather to enlarge the scope of the current legislation goes in the right direction.

For instance, in France, financial institutions (consumer credit, factoring, financial leasing…) are subject to authorisation and supervision by a specialised authority: the "*Autorité de contrôle prudentiel"* (ACP). Currently, these specialised institutions are subject to the same prudential regulation as credit institutions (banks), which is based on Basel 2,5 rules.

Question j: What measures could be envisaged to ensure international consistency in the treatment of shadow banking and avoid global regulatory arbitrage?

In addition to a harmonised treatment of regulation and supervision within the European Union, it is also important to stress that the ongoing international works on shadow banking, lead jointly by the European Commission and the Financial Stability Board (FSB), will bring a real added value only if the gap between Europe and its major economic competitors (especially the USA) is ultimately significantly reduced.

It would actually be unacceptable to create such rules in Europe that would not be set up simultaneously in USA. Maintaining a parallelism between regulation in the EU and regulation in the US is of the utmost importance as a disparate application of the legislation could lead to distortions of competition which would affect the European Union financial system.

This is all the more important if we consider that a distortion of competition already exists in the context of Basel II, which has not yet been implemented by the USA, contrarily to its international commitments.